THE FINANCIAL SERVICES ROUNDTABLE
Impacting Policy. Impacting People.

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Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: FRB Docket No. R–1343; Electronic Fund Transfers; Proposed Amendments to 12 CFR Part 205 - Regulation E and Its Official Staff Commentary

Dear Sir or Madam:

The Financial Services Roundtable ("Roundtable") respectfully submits these comments on the proposal by the Federal Reserve Board (the "Board") to amend Regulation E with respect to certain acts and practices in connection with overdraft services.[1] We note that a number of our members currently provide for opt-out from overdraft services, as well as provide a number of safeguards against triggering overdraft fees. For example, some institutions will send emails or text messages if a customer's account drops below a customer-selected level. Customers may make internal bank transfers from savings accounts to transaction accounts at no cost, and may do so by phone, Internet or other electronic form. Thus, the customer is afforded a number of ways to guard against inadvertent triggering of overdraft fees. Nonetheless, the Board believes that further consumer protections are needed. In response to the proposal, the Roundtable believes that:

- the Board should adopt an opt-out approach;
- financial institutions need the flexibility to vary terms, conditions, and coverage of the opt-out; and
- the proposed treatment of debit holds is not workable within current operational limitations.

I. Background to the Proposal

In May 2008, the Board, along with the Office of Thrift Supervision and the National Credit Union Administration, proposed to prohibit institutions from assessing any fees on a consumer's account in connection with an overdraft service, unless the consumer was given notice and a right to opt out of the service, and the consumer did not exercise that right. In our

[1]The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $85.5 trillion in managed assets, $965 billion in revenue, and 2.3 million jobs.

comment letter on that proposal, the Roundtable raised a number of legal and operational concerns. During the comment period on that proposal, the Board also conducted extensive testing of opt-in and opt-out notices with consumer focus groups. This current proposal results from that input, and we find it to be a considerable improvement over the initial proposal.

We especially appreciate the fact that this proposal does not label prior acceptable practices by the industry as being possibly unfair and deceptive under Section 5 of the Federal Trade Commission Act. As we stated in our earlier comment letter, such an approach would have had a dramatically negative impact upon consumers and the financial services industry.

While we had concerns with the Board's recent amendments to Regulation DD (implementing the Truth-in-Savings Act), which are effective January 1, 2010, these changes will not only materially reduce consumer confusion over overdraft charges but also make unnecessary some of the problematic provisions in this proposal, as we discuss below. The Board's revisions to Regulation DD and the official staff commentary enlarge the coverage of the requirement to disclose overdraft fees on periodic statements to all institutions, not just institutions that promote the payment of overdrafts for a fee. The amendments also add format changes to ensure that the aggregate fee disclosures are more effective and noticeable to consumers. Finally, those amendments require an account balance disclosed to a consumer through any automated system (including, but not limited to, an ATM, Internet website, or telephone response system) to exclude additional amounts that the institution may provide or that may be transferred from another account of the consumer to cover an item where there are insufficient or unavailable funds in the consumer's account. Those changes will ensure that a consumer is not confused or misled when he or she requests an account balance.

II. The Proposal

The Board's consumer research on overdraft services, as well as its review of the comments submitted to its May proposal, led the Board to conclude that a majority of consumers would not opt out of overdraft protection arising from checks written by the consumer. This is logical behavior for the consumer, since a check drawn on insufficient funds will result in an overdraft charge by the financial institution, whether the check is paid or returned. However, if the check is returned, then the consumer is likely to be subject to an additional returned check charge by the merchant, the creation of negative information for credit reports, and potential violations of bad check laws. Most consumers, therefore, do not want to forgo overdraft protection on checks.

However, when the Board tested an opt-out form that limited the opt-out right to ATM withdrawals and one-time debit card transactions made at point of service ("POS") and online, half of the participants indicated that they would consider doing so. Therefore, the Board concludes that consumers should be provided a meaningful opportunity to decide whether to have overdraft protection on ATM withdrawals and one-time debit card transactions.

The Board's proposal may be addressed in three parts: (1) Application of Regulation E (as opposed to Regulation Z); (2) How to provide customer choice for overdraft services; and (3) Debit card holds. As part of the proposal, the Board distinguishes between debit card transactions that are characterized as recurring or multiple.[2] However, as we will discuss below, it is operationally difficult to effectively distinguish between recurring versus one-time debits because the identification of the distinction relies upon the merchant, who has little or no incentive to see that the identification is done correctly.

A. Application of Regulation E

The Board proposes amendments to Section 205.12 of Regulation E that would clarify that both the issuance of an access device with an overdraft service and the addition of an overdraft service to an accepted access device are governed by Regulation E. <u>We support this approach.</u> Coupled with the Regulation DD final rule, it ensures consistent treatment of overdrafts by placing both initiations of overdraft protection under Regulation E, rather than having one under Regulation Z and one under Regulation E.

B. Providing Customer Choice While Minimizing Customer Inconvenience

1. <u>Opt-in versus opt-out</u>

The Board proposes two alternative approaches to providing customers a choice in connection with overdraft services: (1) an opt-out approach, which would prohibit an account-holding financial institution from assessing overdraft fees or charges on a consumer's account for paying an overdraft on an ATM withdrawal or one-time debit card transaction (whether at POS, online or by telephone), unless the consumer is given notice and a reasonable opportunity to opt out of the institution's overdraft service in connection with those transactions, and the consumer does not opt out; or (2) an opt-in approach, which would prohibit an account-holding financial institution from assessing any fees on a consumer's account for paying an ATM withdrawal or one-time debit card transaction that overdraws the account, unless the consumer opts in.

<u>The Roundtable's members are greatly concerned that the adoption of the opt-in approach will have materially negative consequences for the consumer as well as for the general economy. Consequently, we strongly recommend that the Board adopt an opt-out approach.</u>

The opt-in approach will result in significant customer inconvenience. Under an opt-in approach, we estimate that fully 90 percent of consumers will not opt-in, initially. However, many consumers may well opt-in over time as the inconveniences of not having opted-in begin to cumulate. These inconveniences arise from the operational complexity of the payment system. Payment system experts tell us that the operational problems of an opt-in approach are

[2] The Board notes that in its limited consumer testing, participants indicated that they were more likely to pay important bills using checks and preauthorized EFTs, and to use debit cards for their discretionary purchases.

significant and cumulative. Currently, the electronic payment system attempts to integrate thousands of financial institutions as debit card providers, millions of merchants as POS inputs, and hundreds of millions of consumer transactions daily. Many of these are not capable of being done "real-time." For example, many deposits are done as batch transactions at the end of the day as part of the checking clearing process. Under the current system, for example, several of our member banks estimated that together they might process 150 million debit card transactions in a day. Of the POS debit card transactions that are given provisional overdraft credit in a day (that is, at the time they are received the account will have a negative balance), several banks estimated that a majority of these will not be overdrafts after deposits are processed in the evening.

Customers who do not opt-in will have no overdraft protection on debit transactions, and thus all of these transactions now being given provisional overdraft credit must be declined. As customers experience multiple declines, they will query their financial institutions and be told that due to the operational complexities of the payment system, the financial institution must decline the debit card transaction unless it is clear that the transaction is not an overdraft. Of course, the majority of these transactions will not be overdrafts at the end of the day. Customers may then opt-in to restore the convenience and then opt-out only if they actually begin to experience expensive overdrafts.

The opt-in approach will also have a negative impact on business, especially small businesses. Under the opt-in approach, many consumers will experience debit card declines that force them to wait to purchase until their next deposit clears. This will result in a decline in business transactions, especially for small businesses, because consumers will not return the following day to complete a transaction that was declined. We believe that there will be a significant impact on small businesses as they lose these customer sales. Thus, the opt-in approach will have not only increased customer inconvenience, but also a significant negative impact on the consumer economy.

Finally, the opt-in approach poses a significant problem for financial institutions, as the opt-in approach is likely to confuse customers into thinking that, when they opt in, they will have all of their overdrafts paid, which is not correct. Financial institutions are not required to cover an overdraft unless the customer and institution have entered into a formal credit agreement. Without such agreement, the financial institution has the legal right and safety and soundness obligation to not pay overdrafts when there are insufficient funds in customers' accounts. Nevertheless, consumers may believe that they had consented to having all overdrafts by ATM and at POS covered. They would reasonably believe that since non-consent under the opt-in alternative results in no ATM and debit card overdrafts being covered, then consent must mean that all such overdrafts will be covered. This misunderstanding is more likely under the opt-in alternative than the opt-out alternative because the action and formal communication needed to consent compared to refraining from opting out will lead consumers to believe that they are entering into an agreement for a service or benefit, instead of agreeing to let their institution decide if it wants to cover an overdraft.

We believe that the Board's proposed disclosure for opt-in strongly implies that all overdrafts will be covered, because it reads, "We will not pay your overdrafts for ATM withdrawals and debit card purchases you make at a store, online or by telephone, unless you tell us you want overdraft coverage for these transactions. See below for more information, including how to contact us if you want overdraft coverage to apply to your ATM withdrawals and debit card purchases." We believe that this confusion is inherent in the act of opting-in, which is basically inconsistent with a discretionary choice on the part of the financial institution and is not contractually required, as with a credit agreement.

2. Partial or full opt-out

The proposal provides that the opt-out would not apply to ACH transactions. For example, if the consumer provides his or her checking account number to authorize an ACH transfer online or by telephone, the institution would be permitted to pay the item if it overdraws the consumer's account and assess a fee for doing so. The Board notes that, in many cases, ACH transactions serve as a replacement for check transactions, such as where a check is converted to a one-time ACH debit to the consumer's account. In addition, the payment of an overdraft for an ACH transaction could enable consumers to avoid merchant returned item fees. The Board notes that it is specifically concerned that consumers will not opt-out of overdraft services if they are not able to retain overdraft services on checks and ACH transactions when they do opt-out (the chilling effect).

However, the Board also proposes a modified version of proposed Section 205.17(b)(2) that would permit institutions to condition a consumer's ability to opt out of an institution's overdraft service for ATM withdrawals and one-time debit card transactions on the consumer also opting out of the institution's overdraft service for checks and other transaction types. Under this alternative approach, an institution could decline checks, ACH transactions, and other types of transactions because the consumer has opted out of the service for ATM withdrawals and one-time debit card transactions.

The alternative approach would address the potential operational issues associated with implementing a partial opt-out rule. Therefore, the Roundtable recommends that the Board adopts the alternative approach, and permit a financial institution to adopt a full opt-out approach.

Yet a third, and better alternative, would be to not only allow the proposed partial opt-out and the full opt-out, which we believe is necessary because of operational issues for some institutions, but also to provide to financial institutions the flexibility to craft varying sets of opt-out services, in order to be able to meet the different needs of their customers for overdraft protection.

In the event that the Board does not adopt the third or even the second alternative, the Board has acknowledged the expected operational problems by proposing to minimize the cost impact on institutions allowing substantial lead time for institutions to implement the necessary programming changes. At a minimum, we recommend lead time of at least 18 months in order to implement these difficult and substantial changes to multiple systems.

3. Reasonable opportunity to opt-out

Under an opt-out approach, new account holders could be presented with the option at the time of account opening (and could be asked to decide at that time to lessen costs and operational problems in opening new accounts) or could be provided notice anytime thereafter prior to the assessment of any overdraft fees or charges. However, existing account holders would need to receive an offer to opt-out from the financial institution following the assessment of any overdraft fees or charges for paying an ATM withdrawal or one-time debit card transaction. The subsequent notice requirement would apply to all accounts, including existing accounts, as of the effective date of the final rule. In providing for the opportunity to opt-out, the Board asks if it should require financial institutions to provide a toll-free telephone number to ensure that consumers can easily opt out, because participants in the Board's consumer tests indicated that participants would still prefer to call their institution to opt out. Our members are larger banks already operating call centers, and will likely offer their customers the opportunity to phone in their preferences; however, we oppose requiring such a service, given the number of smaller financial institutions that would find meeting such a requirement very expensive, particularly if they do not operate call centers.

The Board also asks if it should add examples of methods of opting out that would not satisfy the requirement to provide a reasonable opportunity to opt out, such as requiring the consumer to write a letter to opt out. We agree that requiring the customer to write a letter (as opposed to mailing back in a form prepared by the bank) is excessive and should be prohibited. However, in cases of joint accounts, the proposed rule allows one owner of the account to trigger opt-out. Because it is impossible operationally to distinguish between users of the same account, the Board's proposal does not ensure that the other owners know one owner has done this. Financial institutions will need some clear proof, written or recorded, that one of the account holders has triggered an opt-out in order to address the potential complaints of the other account holders. Financial institutions should be able to require joint account changes to be in writing.

4. Varying Terms and Conditions

The Board is concerned that institutions may circumvent the proposed opt-out requirement and discourage consumers from opting out by, for example, imposing higher fees, paying lower interest rates, or limiting the features of the opt-out account. Therefore, the Board requests comment on whether institutions that currently offer an opt-out from overdraft services implement that opt-out at the account level (i.e., within the same type of account) or at the product level (i.e., by placing the consumer in a separate opt-out account). We understand that some of our institutions do in fact offer customers an option to opt out, but do so through the use of different accounts, in order to handle the operational difficulties posed by such options. We believe that financial institutions must preserve the right to vary terms and conditions of accounts based upon the services and other features that attach to the account.

5. Exceptions

In limited circumstances, an institution may be unable to avoid paying a transaction that would overdraw a consumer's account. The proposal sets forth two exceptions that would permit an institution to assess a fee or charge to a consumer's account for paying an overdraft for an ATM withdrawal or one-time debit card transaction, even if the consumer has opted out of the institution's overdraft service.

First, there is a proposed "reasonable belief" exception. Some institutions use a daily batch balance method for authorizing transactions and authorization decisions may be based upon a balance which is not updated during the day to reflect other account activity that occurred before the authorization request or transaction on the reasonable belief that a previously deposited check or other item was deposited on good funds, and the item is subsequently returned, causing the transaction to overdraw the consumer's account. Second, an institution would be permitted to assess an overdraft fee or charge, notwithstanding the absence of the consumer's affirmative consent, where a merchant or payee presents a debit card transaction for payment by paper-based means, rather than electronically using a card terminal, and the institution has not previously authorized the transaction. We support the inclusion of both of these exceptions in the final rule.

However, we believe that there is another operational issue that, under the Board's proposal, incorrectly places the burden for the overdraft upon the financial institution. The Board's proposal would prohibit charging an overdraft fee for a transaction not submitted for authorization by the merchant. A transaction may not be submitted for authorization, for example, because it is below the floor limits established by card network rules requiring authorization. Similarly, a merchant may decide not to submit the transaction for authorization because the small dollar amount of the transaction does not pose significant payment risk to the merchant. In either case, the consumer's financial institution would be unable to decline the transaction if the consumer did not have sufficient funds in the consumer's account. Nevertheless, the Board believes that institutions should not be permitted to assess a fee on the consumer's account in these cases when the consumer has opted out. From the perspective of a consumer who has opted out, it is reasonable to expect that the transaction would be declined if he or she did not have sufficient funds in the account. The merchant's decision not to seek authorization for small dollar transactions generally is not transparent to the consumer.[3]

[3] 74 FR 5221.

We note that the proposed regulation includes two types of transactions that may not have been authorized by the financial institution – but it allows the financial institution to charge a fee for one type (transactions not authorized, but submitted as a paper-based item), but not for another (transactions not submitted by the merchant for authorization because of "below-floor" small dollar authorization). In both cases, the consumer is providing his card to a merchant at time of purchase. Current payment system infrastructure does not easily support the identification of a "non-authorized" debit card transaction to ensure that a fee is not assessed for consumers that declined overdraft services – nor can the financial institution currently differentiate fee assessment for subsets of debit card transactions as suggested in this regulation. Significant system development is required throughout the payment processing system (financial institutions, VISA/MC, merchant and card processors) to appropriately identify that a transaction was previously authorized (or not) when the transaction is ultimately submitted to the financial institution for settlement.

Because transactions are not currently "flagged" as authorized or unauthorized, financial institution systems do not currently return (or charge-back) non-authorized debit card transactions to merchants (unless informed by our customer that the transaction was fraudulent). While the examples provided in the proposed regulations imply that non-authorized transactions are limited to small dollar purchases, this is not true. If a large dollar non-authorized transaction was submitted for payment, the financial institution would need to consider the risk of paying this transaction for the customer or charging it back to the merchant. Today, these transactions are paid for our customers – even if a financial institution, through its normal course of business, does not authorize transactions if funds are not available and fees are assessed as applicable. The financial institution will need sufficient time to build processes that will allow not only for a fee differential (if retained), but also for the return of non-authorized debit card transactions.

We believe that the Board's decision to place the burden of this transaction (in which the financial institution has no opportunity to decline the transaction) is erroneous. We note that operationally there is no way (without major changes in how debits cards work) to identify a settled transaction as having been previously authorized or not, so that compliance with the proposal is operationally difficult if not impossible. <u>We recommend that the Board explore either requiring merchants to disclose to consumers that the transaction will not be authorized, and so may overdraft the consumer's account or explore requiring all transactions be authorized.</u>

An additional problem involves decoupled debit cards which are similar to other debit cards but are offered by institutions other than the account holding institution. Transactions for these cards originate as debit card transactions but are converted to ACH transactions by the card-issuer and received by the account-holding institution as ACH transactions. It is impossible for the account-holding institution to know that the transaction started out as a debit card transaction and thus should fall under the overdraft regulations. Therefore, any regulation allowing customers to not have overdraft charges must not apply to decoupled debit cards.

C. Debit Holds

The Board proposes a targeted rule for debit holds that would apply only in circumstances when the actual transaction amount can be determined within a short period of time after the institution authorizes the transaction. The proposed rule would appear to cover approximately 95 percent of all transactions (pay-at-the-pump and restaurants) in which the actual transaction amount and the authorization amount do not match. Thus, the proposed rule would cover the areas of greatest concern regarding overdraft fees incurred because of a debit hold. It would not apply to situations where the transaction amount is not determined within a short period of time after authorization, such as with hotel multi-night stay holds.

We believe that the proposal does not address the operational issues arising from holds. As explained by VISA [in their comment letter on the original 2008 proposal]:

> In restaurant transactions, conventions have evolved where an authorization is obtained for the actual amount of only one part of the transaction, the bill, but not another part, the tip. In order to accommodate these restaurant transactions, the Visa rules have provided for guarantees of transactions over and above the amount authorized to give merchants comfort in accepting payment for these transactions by means of debit cards. The guarantee is for the amount of the bill plus 20%. Because of this guarantee, in some cases issuers place holds on the guaranteed amount, although the Visa experience is that it is typically smaller issuers who use holds in these circumstances. In practice, it is Visa's experience that the authorization amount for restaurant transactions is about 86% of the settlement amount. This settlement amount suggests a tip of about 16% and, therefore, a potential for excess holds of only about 4% for restaurant transactions. Thus, the dollar amount attributed to restaurant holds is relatively small and is not likely to cause consumers to overdraft. As an illustration based on the attached chart, on a typical debit card transaction at a restaurant the settlement amount is $32.67 and on average the amount submitted for authorization by the merchant before adding the tip in was about $28. If an issuer placed a hold on the cardholder's account of 20% above that amount, that hold would have been for $33.72 or about $1 more than the actual transaction amount. The chances that such a small hold in excess of the transaction amount will cause an overdraft are miniscule.

Nonetheless, while the chance of an overdraft being caused by a restaurant hold are small, the Board's proposal would prohibit charging for such an overdraft, yet in this circumstance, the charge appears justified. While near real time transaction information is available for "at the pump" transactions, they are not available for restaurant or similar transactions and will not be available in the foreseeable future. As a result, our bankers are unanimous in telling us that the proposed debit hold rule is as unworkable as the previous one, and will cause significant problems. In order to comply, financial institutions have two bad alternatives: (i) do not charge any overdraft fees on intervening transactions that overdraw during the pendency of a hold (since there are many reasons that a hold may be larger than the settled amount, and not just types of transactions – i.e., a merchant swipes the card twice, but sends in only one transaction) or (ii) to not do authorization holds on the account. Both of these require either massive reprogramming of the system from merchant to financial institution or simply not allowing overdrafts and requiring all transactions to be authorized. <u>In the face of these operational problems, we believe that the proposal will need to be modified to adjust for these operational realities.</u>

III. Conclusion

In conclusion, the Roundtable appreciates the opportunity to comment on this proposal, and urges the Board to further refine the proposal in order to address the operational issues identified in these comments. If you have any questions, please feel free to contact me or Melissa Netram at 202-289-4322.

Sincerely,

Richard M. Whiting

Richard Whiting
Executive Director and General Counsel